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FINANCIAL REPORTING FOR THE DEFENSE LOGISTICS AGENCY -
GENERAL FUNDS AT DEFENSE FINANCE AND
ACCOUNTING SERVICE COLUMBUS

Report No. D-2002-041

January 18, 2002

Office of the Inspector General
Department of Defense

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Abstract <p>We performed this audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires DoD and other Government agencies to prepare audited financial statements. The DoD Agency-wide financial statements include a reporting entity entitled Other Defense Organizations-General Funds. This entity represents a consolidation of financial information from various Defense organizations and funds that use the Treasury Index 97 symbol. This audit focused on abnormal trial balances at Defense Finance and Accounting Service Columbus for the Defense Logistics Agency. As of March 31, 2001, trial balances prepared by Defense Finance and Accounting Service Columbus included net abnormal balances of \$54.4 million, of which \$23.9 million was for the Defense Logistics Agency-General Funds. We reviewed five general ledger accounts with the largest net abnormal balances, totaling \$20.9 million (finding A). We audited the financial reporting procedures that Defense Finance and Accounting Service Columbus used to report on Treasury Index 97 funds.</p>		
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Acronyms

DBMS	Defense Business Management System
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency



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DEPARTMENT OF DEFENSE
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January 18, 2002

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Financial Reporting for the Defense Logistics Agency-
General Funds at Defense Finance and Accounting Service Columbus
(Report No. D-2002-041)

We are providing this report for your information and use. This audit was performed in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. We considered management comments on a draft of this report when preparing the final report.

Defense Finance and Accounting Service Columbus comments conformed to the requirements of DoD Directive 7650.3; therefore, additional comments are not required.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Marvin L. Peek at (703) 604-9587 (DSN 664-9587) (mpeek@dodig.osd.mil) or Ms. Sandra L. Fissel at (703) 604-9485 (DSN 664-9485) (sfissel@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

A handwritten signature in black ink, reading "Thomas F. Gimble", is positioned above the printed name.

Thomas F. Gimble
Acting
Deputy Assistant Inspector General
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Office of the Inspector General, DoD

Report No. D-2002-041

(Project No. D2001FA-0086.001)

January 18, 2002

Financial Reporting for the Defense Logistics Agency- General Funds at Defense Finance and Accounting Service Columbus

Executive Summary

Introduction. We performed this audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires DoD and other Government agencies to prepare audited financial statements. The DoD Agency-wide financial statements include a reporting entity entitled "Other Defense Organizations-General Funds." This entity represents a consolidation of financial information from various Defense organizations and funds that use the Treasury Index 97 symbol. This audit focused on abnormal trial balances at Defense Finance and Accounting Service Columbus for the Defense Logistics Agency. As of March 31, 2001, trial balances prepared by Defense Finance and Accounting Service Columbus included net abnormal balances of \$54.4 million, of which \$23.9 million was for the Defense Logistics Agency-General Funds. We reviewed five general ledger accounts with the largest net abnormal balances, totaling \$20.9 million (finding A). We audited the financial reporting procedures that Defense Finance and Accounting Service Columbus used to report on Treasury Index 97 funds.

Objective. Our audit objective was to determine the accuracy and completeness of the financial data that Defense Finance and Accounting Service Columbus submitted to Defense Finance and Accounting Service Indianapolis (Sustaining Forces) for inclusion in the FY 2001 Other Defense Organizations financial statements. Specifically, we looked at the abnormal balances reported in trial balances prepared by Defense Finance and Accounting Service Columbus. In addition, we reviewed the management controls related to our objective.

Results. The March 31, 2001, trial balances prepared from accounting records maintained by Defense Finance and Accounting Service Columbus included \$23.9 million in net abnormal balances for the Defense Logistics Agency-General Funds. The abnormal balances were not explained in required footnotes. The review of trial balances prepared by Defense Finance and Accounting Service Columbus identified the following deficiencies.

- The Defense Business Management System, a legacy accounting system, significantly limited the ability of accounting personnel to prepare accurate proprietary trial balances (finding A).

- Management controls over the interim processes that Defense Finance and Accounting Service Columbus used to overcome accounting system limitations were not adequate (finding A).
- The allocations of undistributed collections to Accounts Receivable and undistributed disbursements to Accounts Payable were not reasonable or consistent (finding B).

The limitations of the Defense Business Management System have been long-standing and well documented. Unresolved system deficiencies continue to impede DoD's ability to receive a favorable audit opinion on annual financial statements. Until the Defense Business Management System is replaced, account balances will continue to be incorrect and unreliable on the FY 2001, and future financial statements prepared for the Other Defense Organizations. However, the abnormal balances discussed in this report did not have a material effect on the financial statements of Other Defense Organizations-General Funds, nor did they adversely impact the routine operations at Defense Finance and Accounting Service Columbus. See Appendix A for details on the management control program.

Summary of Recommendations. We recommend that Defense Finance and Accounting Service Columbus review quarterly trial balances for abnormal balances; prepare footnotes to address abnormal conditions and accounting system limitations; modify standard operating procedures to address quarterly trial balances preparation and review; and establish a standard methodology for allocating undistributed collections and undistributed disbursements.

Management Comments. The Director, Defense Finance and Accounting Service Columbus, concurred with the findings and recommendations, stating that the identification and explanation of abnormal balances will be completed by the mid-year reports. Defense Finance and Accounting Service Columbus will begin reviews of the quarterly trial balances, continue to improve footnote explanations and revise standard operating procedures. Corrective actions are expected to be completed by April 30, 2002. See the Finding section for a discussion of management comments and the Management Comment section for the text of the comments.

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Background

Other Defense Organizations. The audit was performed as part of the continuing audit work of the Inspector General, DoD, in support of the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires DoD and other Government agencies to prepare audited financial statements. Specifically, the DoD Agency-wide financial statements include a reporting entity entitled “Other Defense Organizations-General Funds.” The reporting entity represents a consolidation of financial information from various Defense organizations and funds that use the Treasury Index 97 Symbol (referred to as Department 97). The FY 2000 financial statements for the Other Defense Organizations-General Funds included \$3.9 billion of net abnormal balances reported in trial balances prepared by supporting accounting offices. The third largest portion of those net abnormal balances, \$395 million, was reported by Defense Finance and Accounting Service (DFAS) Columbus. As of March 31, 2001, trial balances prepared by DFAS Columbus included net abnormal balances of \$54.4 million, of which \$23.9 million was for the Defense Logistics Agency (DLA)-General Funds.

Accounting Support. DFAS Columbus provided accounting support for 10 Other Defense Organizations, which included DLA. Accounting support includes analyzing, reviewing, validating, and reporting obligations, accruals, and disbursements. Accounting support also includes preparing budgetary reports and trial balances. DFAS Columbus used information from the Defense Business Management System (DBMS) to prepare quarterly trial balances that are consolidated at year-end into the financial statements for Other Defense Organizations.

DLA-General Funds. DLA is a logistics combat support agency whose primary role is to provide supply support, technical support, and logistics services to the DoD. In FY 2001, DFAS Columbus reported accounting information for seven DLA-General Fund appropriations, with a combined budget authority of \$385.4 million.

Defense Business Management System. DFAS Columbus uses DBMS to perform general ledger double entry accounting for DLA. DBMS is an automated resource management and accounting system, which DoD has designated as a legacy system. Therefore, according to the DoD Financial Management Improvement Plan, volume II, January 2001, DBMS will be consolidated into the DFAS Business Management Redesign Initiative in September 2003.

Objectives

The audit objective was to determine the accuracy and completeness of the data that DFAS Columbus submitted to DFAS Indianapolis (Sustaining Forces) for

inclusion in the annual Other Defense Organizations financial statements. Specifically, we looked at the abnormal balances reported in trial balances prepared by DFAS Columbus for DLA-General Fund appropriations. In addition, we reviewed DFAS Columbus management controls related to our objectives. See Appendix A for a discussion of the audit scope, methodology, review of the management control program, and prior coverage related to the audit objectives.

A. Accounting for Abnormal Balances

Trial balances prepared for the DLA-General Funds as of March 31, 2001, from accounting records that DFAS Columbus maintained, included \$23.9 million of net abnormal balances, and none were explained in required footnotes. The condition occurred because DFAS Columbus continued to use DBMS, a legacy accounting system that did not produce complete and accurate proprietary trial balances for individual organizations. The condition also occurred because the management controls, for the financial reporting process that DFAS Columbus used to overcome the DBMS limitations, were not adequate. Until DBMS is consolidated into the DFAS Business Management Redesign Initiative in 2003, the abnormal balances and control deficiencies will not be fully corrected. Also, the FY 2001 and future financial statements prepared for the Other Defense Organizations-General Funds will likely be misstated.

Mid-Year Trial Balances

The March 31, 2001, trial balances prepared from accounting records that DFAS Columbus maintained reported \$54.4 million of net abnormal balances, which included \$23.9 million of net abnormal balances in eight general ledger proprietary¹ accounts for DLA-General Fund appropriations. We reviewed five general ledger accounts with the largest net abnormal balances. Those account balances totaled \$20.9 million and represented 87.5 percent of the DLA-General Funds total abnormal balances, as shown in Table 1.

¹Proprietary accounts refer to assets, liabilities, equity, revenues, and expenses, which should be used for preparing internal and external accounting reports.

Table 1. General Ledger Accounts with Net Abnormal Balances for DLA-General Funds as of March 31, 2001			
<u>Account Title</u>	<u>General Ledger Account</u>	<u>Net Abnormal Balance (millions)</u>	<u>Percent of Total Net Abnormal Balances</u>
Accounts Receivable	1310*	\$ 8,771,344	36.7
Revenue from Goods Sold	5100*	3,092,348	12.9
Cost of Goods Sold	6500*	3,092,348	12.9
Expended Appropriations	5700*	2,974,822	12.5
Operating Expense/Program Costs	6100*	<u>2,974,822</u>	<u>12.5</u>
Subtotal		20,905,684	87.5
Fund Balance With Treasury	1010	2,528,004	10.6
Appropriated Capital	3100	441,585	1.8
Advances to Others	1410	<u>14,507</u>	<u>0.1</u>
Total		\$23,889,780	100.0
*General ledger account selected for review.			

General ledger reporting uses separate accounts to record increases and decreases in assets, liabilities, and equity. The normal balance for an account is positive. If an account balance becomes negative, it is abnormal. An abnormal balance represents more decreases to an account than increases and is generally indicative of a reporting anomaly that requires explanation.

DFAS and DLA Use of DBMS

DFAS and DLA continue to use DBMS, which DoD has designated as a legacy system. The results of this audit reiterate the continuing need for DoD to replace legacy systems with systems that are fully compliant with generally accepted Government accounting standards. The limitations of DBMS largely contributed to the abnormal balances we reviewed. Because DBMS is a legacy

system, limited funding is available to change the system. DoD Memorandum, "Accelerated Implementation of Migration Systems, Data Standards, and Process Improvement," October 13, 1993, states that "funding for development, modernization, or enhancement of legacy systems..." is limited to mission essential changes. DBMS limitations have been long standing and well documented. In response to Inspector General, DoD, Report No. 98-134, "Payroll Expenses Reported by the Defense Finance and Accounting Service Columbus Center," May 14, 1998, DFAS stated that they were reviewing alternatives to replace DBMS; however, DFAS Columbus is still using DBMS. System deficiencies will continue to exist until DBMS is consolidated into the DFAS Business Management Redesign Initiative, which is currently scheduled for September 2003. According to the General Accounting Office, unresolved system deficiencies impede DoD's ability to obtain reliable financial data and prepare annual financial statements.² Unresolved system deficiencies continue to be a critical obstacle to DoD's ability to receive a favorable audit opinion on annual financial statements.

Process Used to Prepare Proprietary Trial Balances

DFAS Columbus used a combination of automated and manual processes to prepare trial balances for organizations receiving general fund appropriations. The abnormal balances occurred in part because of DBMS limitations.

DBMS Limitations. DBMS cannot produce complete trial balances for individual organizations. A complete trial balance contains proprietary accounts that show the current status of assets, liabilities, equity, revenues, and expenses. The trial balance also contains budgetary accounts that show the source and status of budgetary resources. DBMS produced separate trial balances for proprietary accounts and for budgetary accounts.

Proprietary Trial Balances. DBMS produced a proprietary trial balance for each general fund appropriation but not for each organization. The appropriation level proprietary trial balances report the combined balances for all organizations funded by the appropriation. Because financial statements are prepared for individual organizations, the appropriation level proprietary trial balances are not useful for financial statement reporting. As a result, DFAS Columbus did not use the appropriation level proprietary trial balances.

Budgetary Trial Balances. DBMS produced budgetary trial balances for each organization. Accounting personnel use the budgetary trial balances, along with accounting information from other sources to approximate the proprietary account balances for each organization. However, budgetary accounts have limited capability for calculating balances in proprietary accounts. Budgetary accounts are not designed to report assets, liabilities, equity, revenues

²General Accounting Office, Report No. GAO-02-29, "FFMIA Implementation Critical for Federal Accountability," October 1, 2001.

or expenses. Furthermore, budgetary accounts do not provide the capability to differentiate between adjustments affecting the current reporting period and those affecting a prior reporting period.

Abnormal Balances Created Due to DBMS Limitations. Of the \$23.9 million of net abnormal balances, DBMS limitations contributed to net abnormal balances of \$12.1 million reported in the following four proprietary accounts:

- Cost of Goods Sold (general ledger account 6500),
- Revenue from Goods Sold (general ledger account 5100),
- Expended Appropriations (general ledger account 5700), and
- Operating Expenses/Program Costs (general ledger account 6100).

All four accounts are nominal³ accounts and, therefore, close at the end of each reporting period. DFAS and DLA accounting personnel posted increases and decreases during FY 2001 to those four accounts to correct transactions posted in previous fiscal years. The recorded decreases exceeded the recorded increases, creating an abnormal balance in each account. Those adjustments should have been posted to Prior Period Adjustments (general ledger account 7400), a proprietary account. At the end of each fiscal year, general ledger account 7400 is closed to Cumulative Results of Operations and does not affect current year receivables, payables, revenues, and expenses. DFAS Columbus accounting personnel did not use general ledger account 7400 because DBMS did not have the capability to report a balance in that account for each organization.

Management Controls Over the Interim Reporting Process

DoD Regulation 7000.14-R, “DoD Financial Management Regulation,” volume 6A, chapter 2, “Departmental Financial Reporting Roles and Responsibilities,” February 1996 (with changes through 2001), requires each accounting office to establish management controls. Management controls should ensure financial reports are reliable, accurate and supported by a clear audit trail. However, the procedures in place at DFAS Columbus did not provide adequate control over the:

- use of spreadsheets,
- review of trial balances,

³Proprietary nominal accounts reflect accounting information for a single fiscal year and are closed at the end of each fiscal year to Cumulative Results of Operations (general ledger account 3310). The accounts begin the following year with a zero balance. Revenue and expense accounts are nominal accounts.

-
- preparation of explanatory footnotes, and
 - documentation of audit trails.

Controls Over Spreadsheets. To prepare proprietary trial balances, DFAS Columbus accounting personnel developed elaborate spreadsheets, imported budgetary account balances from DBMS into the spreadsheets, and subsequently used the budgetary balances to calculate balances for proprietary accounts. The spreadsheets contained numerous complex formulas for manipulating data. Those same types of spreadsheets used different formulas to calculate balances for identical proprietary accounts. The inconsistencies occurred, in part, because accounting personnel had not thoroughly reviewed the spreadsheets to ensure consistency and accuracy among the formulas. When interviewed, accounting personnel stated they had inherited the spreadsheets and that documentation did not exist to explain the rationale supporting the formulas. For example, one spreadsheet had an incorrect formula that directly contributed to an abnormal balance. At least \$2.6 million of the \$2.7 million net abnormal balance reported in Revenue From Goods Sold (general ledger account 5100) occurred because a spreadsheet formula included a wrong account.

Controls Over Reviewing Trial Balances. Although DFAS Columbus had management control procedures over the financial reporting process, significant opportunities for improvement existed. For example, DFAS Columbus submitted FY 2000 year-end trial balances to DFAS Indianapolis (Sustaining Forces) for inclusion in the financial statements without thoroughly reviewing the trial balances for abnormal conditions, as required.⁴ The trial balance prepared for the DLA-General Funds included \$227 million of net abnormal balances in Accounts Payable-Federal (general ledger account 2110). Those abnormal balances occurred because multiple accounts were incorrectly included in the spreadsheet formulas used to calculate the balance. Had DFAS Columbus performed a thorough review of the trial balances, accounting personnel could have detected the incorrect accounts included in the formula. DFAS Columbus should revise its standard operating procedure, “Trial Balance Report, Review, and Reconciliation,” October 1, 1997, to provide detailed instructions on reviewing quarterly and year-end trial balances for abnormal balances.

Required Footnotes. DFAS Indianapolis Memorandum, “Year-End Instructions for Defense Agencies,” June 16, 2000,⁵ states that accounting offices reporting Department 97 funds must explain abnormal balances in footnotes. Footnotes should explain the circumstances surrounding the abnormal balance, corrective actions being taken, and a date when the balance is to be corrected. DFAS Columbus accounting personnel were not aware that footnotes were required for the quarterly trial balances and did not submit

⁴DoD Regulation 7000.14-R, volume 6A, chapter 2, “Departmental Financial Reports Roles and Responsibilities,” February 1996 (with changes through 2001), requires both DFAS and the DoD component, in this case DLA, to review financial reports for abnormal balances. When DFAS and the DoD component identify deficiencies, they are required to initiate research and take action to resolve the deficiencies.

⁵DFAS Indianapolis Memorandum, “Year-End Instructions for Defense Agencies,” was reissued in June 2001 for FY 2001 and requires accounting offices to prepare explanatory footnotes.

footnotes for the March 31, 2001, trial balances. We informed DFAS Columbus of the requirement, and accounting personnel prepared and submitted footnotes with the June 2001 quarterly trial balances.

Lack of Audit Trails. We, along with DFAS Columbus accounting personnel, attempted to research the cause of the \$8.7 million net abnormal balance in Accounts Receivable (general ledger account 1310) reported in the March 31, 2001, trial balance. However, an adequate audit trail did not exist. DFAS Columbus accounting personnel could not provide a complete explanation or supporting documentation at the transaction level for the abnormal balance. DFAS Columbus acknowledged that the interim reporting process, combined with the limited capabilities of DBMS, did not provide an adequate audit trail.

Summary

We reviewed abnormal balances in five of the eight general ledger accounts that reported abnormal balances. The causes for abnormal balances in those five accounts were created because of system limitations and because of flawed business practices. Although net abnormal balances may be immaterial dollar amounts, they represent cumulative financial activity and may be indicators of potentially material problems. Therefore, DFAS Columbus should review remaining general ledger accounts with abnormal balances to identify the cause of the abnormal balances and determine whether those abnormal balances occurred because of system limitations that cannot be changed, or because of business processes that can be changed.

Recommendations and Management Comments

We recommend that the Director, Defense Finance and Accounting Service Columbus:

1. Initiate a review of all abnormal general ledger accounts in the Defense Logistics Agency-General Funds. Determine the cause of those net abnormal balances, document the causes, and, where possible, correct the balances. (See Table 1. for a listing of abnormal balances as of March 31, 2001.)

Management Comments. DFAS Columbus concurred and stated that DBMS software release 13.5 provides a tool that identifies and displays proprietary accounts for General Funds by program year, which may provide additional functionality to DBMS for researching abnormal balances. DFAS Columbus will start providing analysis of abnormal balances for individual trial balances at the suballotment level beginning with the January 2002 trial balances. Also, the Agency Reporting Division will complete identification and explanation of abnormal balances by April 30, 2002.

2. Modify standard operating procedures to require Defense Finance and Accounting Service Columbus accounting personnel to perform routine reviews of the quarterly trial balances provided to the Defense Finance and Accounting Service Indianapolis (Sustaining Forces) to:

a. Identify abnormal balances;

Management Comments. DFAS concurred and will revise standard operating procedures by April 30, 2002, to provide detailed instructions for reviewing quarterly and year-end trial balances for abnormal balances beginning with the March 2002 reports.

b. Document the cause and effect of abnormal balances and explain, as necessary, any system limitations causing the abnormal balances;

Management Comments. DFAS Columbus concurred and will update standard operating procedures. The standard operating procedures will state that the operational areas, on a monthly basis, will provide the Agency Reporting Division with an analysis of abnormal balances. The analysis will include explanations of those abnormal balances at the individual trial balance level. The Agency Reporting Division will use this information when preparing the March 2002 reports. The estimated completion date is April 30, 2002.

c. Provide footnote explanations of abnormal conditions to the Defense Finance and Accounting Service Indianapolis (Sustaining Forces) for use in preparing the financial statements; and

Management Comments. DFAS Columbus concurred and began improving footnote explanations with the October 2001 reports and stated that they will be in full compliance as of the March 2002 reports. The standard operating procedures will be updated to include the footnote responsibilities by April 30, 2002.

d. Correct abnormal balances generated by business process anomalies.

Management Comments. DFAS Columbus concurred in principle and stated that, if possible, they will correct abnormal balances generated by business anomalies. The operational areas will provide information to the Agency Reporting Division to correct those abnormal balances beginning with the March 2002 reports.

B. Accounting for Undistributed Collections and Disbursements

For the March 31, 2001, DLA-General Funds trial balances, DFAS Columbus did not consistently allocate:

- undistributed collections of \$47 million to Accounts Receivable Federal and Accounts Receivable Public, and
- undistributed disbursements of \$42.3 million to Accounts Payable Federal and Accounts Payable Public.

DFAS Columbus used different percentages for different appropriations and could not provide a reasonable rationale for using the diverse percentages. The condition occurred because DFAS Columbus had not developed and documented a standard allocation methodology. DFAS Columbus acknowledged that the process was not consistent and, in July 2001, initiated action to develop a standard methodology for performing a reasonable allocation that can be consistently applied to all DLA-General Fund appropriations. Until fully corrected, the financial statements will not consistently report undistributed collections and disbursements.

Undistributed Collections and Disbursements

Origin of Undistributed Collections and Disbursements. As of March 31, 2001, the DLA-General Funds trial balances reported \$47 million of undistributed collections and \$42.3 million of undistributed disbursements. Undistributed collections and disbursements represent the differences between U.S. Treasury records and the accounting records that DFAS Columbus maintained for DLA-General Funds. DFAS Columbus attributed those differences to collections and disbursement transactions that are in-transit. Thus, it is reasonable to allocate undistributed collections and disbursements as a result of the ratio of Federal receivables to public receivables, and Federal payables to public payables, respectively⁶. However, because DBMS summarized DLA-General Funds entities on the proprietary trial balances, DFAS Columbus was unable to differentiate between Federal and public receivables and payables. Therefore, because of DBMS limitations, DFAS Columbus adopted a process that adjusted the accounting records to reflect the collections and disbursements reported by the U.S. Treasury. As part of the adjustment, DFAS Columbus adjusts Accounts Receivable (Federal and public) and Accounts Payable (Federal and public).

⁶Accounts receivable are liquidated by collections and accounts payable are liquidated by disbursements.

Allocation Percentages. We reviewed the percentages that DFAS Columbus used to allocate undistributed collections and disbursements between Federal and public Accounts Receivable and Federal and public Accounts Payable for the September 30, 2000, and March 31, 2001, time periods. The allocation percentages used did not provide a current basis that was reasonable. The percentages were not consistent between appropriations or between time periods. In addition, large unexplained positive and negative percentages were applied to allocate undistributed disbursements, as shown in Table 2.

Table 2. Examples of Inconsistent Allocation Percentages Used by DFAS Columbus to Report Undistributed Disbursements		
Basic Symbol ¹ Date	Allocations to Accounts Payable Federal (percent)	Allocations to Accounts Payable Public (percent)
0100		
September 2000	6.43	93.57
March 2001	100.00	0.00
0400²		
September 2000	-54731.86 ³	54831.86 ³
March 2001	188.89	-88.89
0500		
September 2000	170.49 ³	-70.49 ³
March 2001	100.00	0.00
0834		
September 2000	61.12	38.88
March 2001	86.79	13.21
¹ The basic symbol represents a specific appropriation.		
² Basic symbol 0400, "Research, Development, Test and Evaluation," is an appropriation that receives money that can be obligated for two years. The numbers used represent the percentages applied to funds available for obligation from FY 1999 through FY 2000.		
³ Percents over 100, when combined with the corresponding negative percent, allocated 100 percent of the undistributed amounts		

Basis for Allocating Undistributed Collections and Disbursements. DFAS Columbus accounting personnel could not provide an explanation for the logic behind the diverse percentages used to allocate the undistributed collections to Accounts Receivable and the undistributed disbursements to Accounts Payable. As a result of system and process deficiencies, a complete reconciliation cannot be performed between U.S. Treasury records and DFAS Columbus accounting records. Therefore, it is reasonable that DFAS Columbus estimate that the

proper amount of undistributed collections and disbursements to be allocated to Accounts Receivable (Federal and public) and Accounts Payable (Federal and public). However, the estimate should be calculated using a reasonable, consistent, and clearly documented basis. This has not been the case. As shown in Table 2, the adjustments made to allocate undistributed amounts were inconsistent and caused gross distortions to Accounts Payable.

Corrective Actions Initiated by DFAS Columbus. During the audit, we informed DFAS Columbus accounting personnel of the inconsistencies in the allocation process. In response, DFAS Columbus initiated actions to develop a methodology that would apply the undistributed collections and disbursements consistently and reasonably to Accounts Receivable (Federal and public) and Accounts Payable (Federal and public) to all DLA-General Fund appropriations. DFAS Columbus plans to implement a new methodology for allocating the undistributed collections and disbursements beginning the first quarter of FY 2002.

Impact on the Financial Statements

The proper allocation of undistributed collections and disbursements to Federal and public accounts is important to ensure the accuracy and integrity of the Other Defense Organizations financial statements. The allocation is important to avoid creating abnormal balances and to prepare eliminating entries.

Abnormal Balances. Unless reasonable and consistent percentages are used to allocate undistributed collections and disbursements, the account balances reported on the financial statements are at risk of reporting abnormal balances. For example, the September 30, 2000, trial balances prepared for the DLA-General Funds included at least \$22.6 million of net abnormal balances in Accounts Payable-Federal, which was created by the percentage used to allocate undistributed disbursements. Until a standard methodology is created that uses a reasonable basis for allocating undistributed collections and disbursements, the FY 2001 and future financial statements are at risk of being misstated.

Eliminating Entries. According to DoD Regulation 7000.14-R, volume 6B, chapter 13, "Fiscal Year 2000 Adjustments, Eliminations, and Other Special Intragovernmental Reconciliation Procedures," October 2000, transactions among sub-entities must be eliminated when consolidated financial statements are prepared for the parent entity. When DLA-General Funds are consolidated with Other Defense Organizations and the Military Departments into the Defense Agency-wide financial statements, the transactions between DLA-General Funds and other DoD entities must be eliminated.

Recommendation and Management Comments

We recommend that the Director, Defense Finance and Accounting Service Columbus, establish a standard methodology to allocate the undistributed collections to Accounts Receivable (Federal and public) and the undistributed disbursements to Accounts Payable (Federal and public). This methodology should be documented, communicated to all accountants, and used consistently among the Defense Logistics Agency-General Fund appropriations.

Management Comments. DFAS Columbus concurred and will revise standard operating procedures by April 30, 2002, to provide detailed steps to improve tracking of undistributed collections and disbursements down to the trial balance level. Those procedures will eliminate the need to allocate undistributed collections and disbursements based on percentages. The revised procedures will also improve coordination between operational and reporting areas.

Appendix A. Audit Process

Scope

Financial Information, Procedures, and Controls Reviewed. We reviewed the procedures and related controls used by DFAS Columbus to prepare quarterly and year-end trial balances for Other Defense Organizations. We specifically focused on abnormal balances reported in trial balances. The FY 2000 financial statements for the Other Defense Organizations-General Funds included \$3.9 billion of abnormal balances reported in trial balances prepared by supporting accounting offices. DFAS Columbus reported \$395 million of those abnormal balances, the third largest portion. Therefore, we performed detailed audit work on the FY 2001 mid-year trial balances prepared by DFAS Columbus. As of March 31, 2001, trial balances prepared by DFAS Columbus reported \$54.4 million in net abnormal balances, of which \$23.9 million was attributed to the DLA-General Funds. We reviewed the abnormal balances for the DLA-General Funds because there was no audit coverage for the DLA-General Funds. We reviewed detailed transactions totaling \$20.9 million in five general ledger accounts from trial balances prepared by DFAS Columbus as of March 31, 2001. We also performed reviews of the September 30, 2000, trial balances. We reviewed written standard operating procedures, budgetary reports and trial balances for the FY 2000 and FY 2001 reporting periods. We also interviewed DFAS Columbus personnel to determine how information is obtained, recorded, reported, and reviewed in trial balance reports.

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in the DoD. This report provides coverage of the DoD Financial Management high-risk area.

Methodology

Review of Abnormal Balances. We identified eight general ledger accounts with net abnormal balances of \$23.9 million prepared from accounting records maintained by DFAS Columbus for the DLA-General Funds. We then selected and reviewed five general ledger accounts with net abnormal balances greater than \$2.6 million. The five balances reviewed were Accounts Receivable, Revenue from Goods Sold, Cost of Goods Sold, Expended Appropriations, and Operating Expense/Program Costs, which totaled \$20.9 million. We also performed a review of trial balances prepared by DFAS Columbus as of September 30, 2000, to identify the total net abnormal balances at fiscal year-end. We employed a business process approach to evaluate how DBMS users recorded adjustments to revenue and expense accounts and successfully determined at least one major cause of the abnormal balances in those accounts.

Use of Computer-Processed Data. We relied on computer-processed accounting information contained in DBMS at DFAS Columbus. DBMS is a DoD legacy system and is scheduled for consolidation into the DFAS Business Management Redesign Initiative in September 2003. We obtained information for collections, disbursements, revenues, and expenses. We also relied on data produced from Microsoft Excel spreadsheets that DFAS Columbus developed to calculate proprietary balances for quarterly and year-end trial balances. The spreadsheets contained complex formulas for manipulating accounting information from the DBMS. We performed testing on the DBMS and Microsoft Excel spreadsheets by reviewing balances, transactions, and business processes. Our assessments showed that DBMS and the Microsoft Excel spreadsheets could not produce complete and accurate trial balances for individual organizations. Our review further showed that DBMS could not properly post prior period adjustments. However, our reliance on computer processed data did not affect our audit conclusions.

Audit Type, Date, and Standards. We performed this financial-related audit from May 2001 through October 2001, at DFAS Columbus, Columbus, Ohio, and DFAS Indianapolis (Sustaining Forces), Indianapolis, Indiana, in accordance with generally accepted Government auditing standards. We included tests of management controls considered necessary.

Contacts During the Audit. We visited and contacted individuals and organizations within DoD. Further details are available on request.

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We reviewed the adequacy of DFAS Columbus management controls over Department 97 financial reporting. Specifically, we reviewed controls over the preparation and review of trial balances. We reviewed management's self-evaluation applicable to those controls.

Adequacy of Management Controls. We did not identify a material management control weakness for DFAS Columbus as defined by DoD Instruction 5010.40. The abnormal balances occurred in part because of the way DBMS was configured; however, because DBMS is a DoD legacy system, we did not make recommendations to change its configuration. Further, the abnormal balances we reviewed did not have a material effect on the financial statements. DoD has compiled the FY 2000 Financial Management Improvement Plan that designates DBMS as a legacy system. The designation

as a legacy system acknowledges for all users that DBMS has limitations and will, therefore, be consolidated into the DFAS Business Management Redesign Initiative in September 2003.

Prior Coverage

The General Accounting Office and the Inspector General, DoD, have conducted multiple reviews related to financial statement issues. General Accounting Office reports can be accessed on the Internet at <http://www.gao.gov>. Inspector General, DoD, reports can be accessed on the Internet at <http://www.dodig.osd.mil/audit/reports>.

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Columbus
Director, Defense Logistics Agency

Non-Defense Federal Organization

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member (cont'd)

House Committee on Appropriations

House Subcommittee on Defense, Committee on Appropriations

House Committee on Armed Services

House Committee on Government Reform

House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform

House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform

House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

Defense Finance and Accounting Service Columbus Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE COLUMBUS CENTER

P.O. BOX 182317
COLUMBUS, OHIO 43218-2317

IN REPLY
REFER TO

DFAS-AITP/CA

DEC 21 2001

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING
DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL
FOR AUDITING, DOD

SUBJECT: DoD-IG Draft Report, Project No. D2001FA-0086.001, "Financial Reporting
for the Defense Logistics Agency – General Funds at Defense Finance and
Accounting Service Columbus," dated October 26, 2001

The attached provides our comments on the findings and recommendations of
subject draft report.

Questions or requests for additional information may be directed to Linda Royal,
DFAS-AITP/CA, DSN 869-7098 or (614) 693-7098.

Nancy Zryzylinski
Nancy Zryzylinski

Director, Accounting Services – Client Executive
DFAS Columbus

Attachment
As stated

cc:
DFAS-DAS

**DFAS RESPONSE TO THE DOD-IG DRAFT REPORT, PROJECT NO. D2001FA-0086.001, "FINANCIAL REPORTING FOR THE DEFENSE LOGISTICS AGENCY-GENERAL FUNDS AT DEFENSE FINANCE AND ACCOUNTING SERVICE COLUMBUS,"
DATED OCTOBER 26, 2001**

JANUARY 2002 RESPONSE

RECOMMENDATIONS:

Recommendation A.1: We recommend that the Director, Defense Finance and Accounting Service Columbus, initiate a review of all abnormal general ledger accounts in the Defense Logistics Agency-General Funds. Determine the cause of those net abnormal balances, document the causes, and, where possible, correct the balances. (See Table 1. for a listing of abnormal balances as of March 31, 2001.)

Concur. It is true that the Defense Management System (DBMS) for General Funds does not produce a proprietary trial balance broken out by Program Year or Subhead/Allotment Serial Number level. DBMS release 13.5 now has a listing that provides a trial balance tool that breaks proprietary accounts at the Line of Accounting (LOA) level. The report ID is DPFR730A. This may provide additional functionality to DBMS for researching abnormal balances. However, analysis regarding this capability needs to be performed. Nothing further is planned since DBMS is a legacy system.

Finding and recommendation is directed at "net abnormal balances" (computed by Agency Reporting). Our operational area provides accounting service to customers at the individual trial balance suballotment level. General Fund Reports are consolidated and adjusted at Agency Reporting level and report "net balances". The operational areas will start providing Agency Reporting with the individual trial balance abnormal balance analysis at the suballotment level on a monthly basis beginning with the January reporting month. Each analysis will provide the cause and corrective action, if possible. Agency Reporting will complete their identification and explanation of abnormal balances by the mid-year reports.

Estimated completion date: April 30, 2002.

Recommendation A.2.a: We recommend that the Director, Defense Finance and Accounting Service Columbus, modify standard operating procedures to require Defense Finance and Accounting Service Columbus accounting personnel to perform routine reviews of the

quarterly trial balances provided to the Defense Finance and Accounting Service Indianapolis (Sustaining Forces) "to identify abnormal balances".

Concur. We will begin reviews of the quarterly trial balances with the March reports. The Standard Operating Procedure (SOP), "Trial Balance Report, Review, and Reconciliation" will be revised to provide detailed instructions on reviewing quarterly and yearend trial balances for abnormal balances.

Estimated completion date: April 30, 2002.

Recommendation A.2.b: We recommend that the Director, Defense Finance and Accounting Service Columbus, modify standard operating procedures to require Defense Finance and Accounting Service Columbus accounting personnel to perform routine reviews of the quarterly trial balances provided to the Defense Finance and Accounting Service Indianapolis (Sustaining Forces) to "document the cause and effect of abnormal balances and explain, as necessary, any system limitations causing the abnormal balances."

Concur. We will add to our SOP that on a monthly basis, the operational areas will provide Agency Reporting with an analysis to include explanations of abnormal balances at individual trial balance level, to include any caused by system limitations. Spreadsheet formulas have been revised to reflect the correct balances beginning with the November reports. Agency Reporting will use this information in preparing their reports and analysis, beginning with March reports.

Estimated completion date: April 30, 2002.

Recommendation A.2.c: We recommend that the Director, Defense Finance and Accounting Service Columbus, modify standard operating procedures to require Defense Finance and Accounting Service Columbus accounting personnel to perform routine reviews of the quarterly trial balances provided to the Defense Finance and Accounting Service Indianapolis (Sustaining Forces) to "provide footnote explanations to the Defense Finance and Accounting Service Indianapolis (Sustaining Forces) for use in preparing the financial statements."

Concur. Agency Reporting has begun footnote explanations. We improved the footnotes beginning with the FY 2002 October reports. We will continue this effort and will be in full compliance as of the March reports. The operational areas will provide monthly explanations at the individual trial balance level beginning with

March reports. The SOP will be updated with the footnote responsibility.

Estimated completion date: April 30, 2002.

Recommendation A.2.d: We recommend that the Director, Defense Finance and Accounting Service Columbus, modify standard operating procedures to require Defense Finance and Accounting Service Columbus accounting personnel to perform routine reviews of the quarterly trial balances provided to the Defense Finance and Accounting Service Indianapolis (Sustaining Forces) to "correct abnormal balances generated by business process anomalies."

Concur in principle. We concur that we should correct abnormal balances generated by business anomalies, if possible. However, after reviewing the report we are unsure as to what business anomaly was identified. One possible process anomaly could deal with prior period adjustments. If this is the anomaly referenced, we feel this business process anomaly will need to continue in order to maintain and support the ledger relationships and reconciliations. The operational areas will coordinate and provide information for Agency Reporting to correct these abnormal balances where possible, effective with the March reports.

Estimated completion date: April 30, 2002.

Recommendation B: We recommend that the Director, Defense Finance and Accounting Service Columbus, establish a standard methodology to allocate the undistributed collections to Accounts Receivable (Federal and public) and the undistributed disbursements to Accounts Payable (Federal and public). This methodology should be documented, communicated to all accountants, and used consistently among the Defense Logistics Agency-General Fund appropriations.

Concur. Currently we allocate the undistributed collections to Accounts Receivable (A/R) (Federal and public) and the Undistributed Disbursements to Accounts Payable (A/P) (Federal and public) based upon the percentage of the Federal and public A/R and A/P in the trial balances. Improved tracking down to the trial balance level and improved coordination between operational and reporting areas will alleviate the situation. We will provide the detailed steps of the process in a revised SOP by the estimated completion.

Estimated completion date: April 30, 2002.

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report are listed below.

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